



THE DREYFUS CORPORATION

August 9, 2016

Mr. Kevin Fry
Chairman, Valuation of Securities Task Force
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106

RE: Elimination of NAIC Class 1 List

Dear Chairman Fry:

Founded in 1951, The Dreyfus Corporation ("Dreyfus") is the investment adviser to the Dreyfus Family of Mutual Funds and a subsidiary of BNY Mellon, an investment company that has in excess of \$30 trillion under management, custody, or administration. Dreyfus has a historic pedigree in the mutual fund industry, credited with creation of the first bond fund, and pioneering the use of the first direct marketed, retail no-load money market fund, which led the way to the tremendous expansion of the money market fund industry in the decades that followed. We have a diverse clientele that includes individuals, retirement plans, corporations, banks, broker-dealers and insurance companies. Our insurance company clients typically use money market funds as a cash management tool, and invest in the funds that are on one of two National Association of Insurance Commissioners ("NAIC") money market fund lists: the U.S. Direct Obligations/Full Faith and Credit ("DOFFC") Exempt List and the Class 1 List. In general, when reporting insurance companies invest in these listed money market funds, such investments are eligible for favorable reserve treatment. Recently, however, as the result of changes to Rule 2a-7 (17 CFR 270.2a-7) of the Investment Company Act of 1940, as amended (the "1940 Act"), the NAIC's Valuation of Securities Task Force made the decision to eliminate the Class 1 List. As further discussed below, this decision generally will cause insurance company investments in non-government money market funds to be subject to radically different, less favorable reserve treatment than they are currently. As the result of the concerns expressed by our insurance company clients over the NAIC's decision, we offer our comments and suggestions today.

According to the existing provisions under Part Six, Section 2(b)(ii) of the Purposes and Procedures Manual ("P&P Manual"), in order for a money market fund to qualify for the Class 1 List, the fund must:

- (A) maintain a rating of Am or better from Standard and Poor's or a rating of A-mf or better from Moody's Investor's Services, or an equivalent or better rating from another NAIC Credit Rating Provider ("CRP");
- (B) maintain a stable net asset value of \$1.00 at all times;
- (C) allow a maximum of seven-day redemption of proceeds; and
- (D) invest at least ninety-seven percent (97%) of its total assets in any combination of the following:
 - the U.S. Government securities listed in Section 2(e) of this Part,
 - securities rated in the highest short-term rating category by an NAIC CRP,
 - unrated securities determined by the fund's board to be of comparable quality,
 - securities of money market funds that are registered investment companies, and
 - collateralized repurchase agreements comprised of such obligations at all times.

The remaining three percent (3%) may be invested in "Second Tier Securities" as such phrase is defined by Rule 2a-7.



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Rule 2a-7 as modified by the amendments that go into effect in October of this year (the "Amended Rule") makes it impermissible for a non-government money market fund to maintain a stable net asset value ("NAV") as required by item (B) above, unless the fund adopts reasonably designed policies and procedures to assure that all investors in the fund are limited to natural persons. This natural person requirement forecloses any investment by insurance companies in a non-government, stable NAV money market fund, and is the stated reason for the NAIC's proposed elimination of the Class 1 List. As the January 20, 2016, communication from the NAIC's Rob Johnson explains, the NAIC's elimination of the Class 1 List:

"...reflects the adoption by the US Securities and Exchange Commission (SEC) of revised rules for money market funds. As relevant to the NAIC decision, the SEC's new rules, which are effective October 14, 2016, mean that prime institutional funds may no longer report a stable net asset value (NAV) but must instead report a floating NAV. It is our understanding therefore that under the new rules, money market funds such as those now on the Class 1 List can no longer be offered after October 14, 2016."

Mr. Johnson's statement that "...money market funds such as those now on the Class 1 List can no longer be offered..." is accurate. However, as the consequence of using this rationale to eliminate the Class 1 List, the NAIC has put insurance companies in the contradictory position of having to treat any investment in non-government money market funds, whose underlying assets are composed virtually entirely of bonds, as an investment in common stock for reserve treatment purposes, notwithstanding the fact that not one share of common stock may be found in the fund's portfolio. We believe that, in light of the nature of their underlying investments, non-government money market funds should continue to be treated as a bond investment, rather than as common stock.

According to Mr. Johnson's communication, "The NAIC Class 1 Fund construct was developed to permit insurance companies to report shares of money market funds **with stable NAV** as bonds instead of as shares of common stock..." (emphasis in the original). While we believe a stable NAV provides several benefits, we do not believe that making shares of a money market fund more 'bond-like' is one of them. That is, a bond is rarely traded at its face value; rather, it can only be relied upon to be worth its face value when it is held to, and redeemed at, maturity. At any other point in its life cycle, a bond is likely to trade higher or lower than face value based on market conditions. If prevailing interest rates rise above the bond's coupon rate, all other factors being equal, the bond will trade at a discount from its face value; conversely, if prevailing interest rates fall below the bond's coupon rate, the bond will trade at a premium. Therefore, a fluctuating NAV on a money market fund composed entirely of bonds may actually make the fund more 'bond-like' than one with a stable NAV. Moreover, even those money market funds with a stable NAV do not guarantee the stability of that NAV; on the contrary, they merely manage the portfolio with the goal of maintaining a stable NAV, but there is no guarantee the fund will be able to achieve that goal. For instance, all money market funds with a stable NAV are required to include the following prospectus disclosure in accordance with the requirements of Form N-1A: You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at \$1.00 per share, it cannot guarantee it will do so.

A secondary rationale for elimination of the Class 1 List cited by Mr. Johnson's communication is that, under the Amended Rule, money market funds will be permitted to impose a temporary redemption gate of up to 10 days: "Changes in rules adopted by the SEC affect other NAIC requirements as well; notably, the requirement for redemption on demand and within 7 days (under the new rules redemptions of shares in prime institutional funds may be subject to suspensions, fees and gates)." According to the existing provisions under Part Six, Section 2(b)(ii)(C) of the P&P Manual, a fund on the Class 1 List must allow a maximum of seven-day redemption of proceeds. However, all money market funds are permitted to suspend redemptions in times of stress under the existing provisions of Rule 2a-7 (before modification by the Amended Rule). This fact has not precluded the inclusion of money market funds on both the DOFFC Exempt List and the Class 1 List. The primary difference between the current regulatory structure and the new one is that, under the current structure, the fund is required to be liquidated subsequent to suspending redemptions. This is not the case under the Amended Rule. In light of this, we



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believe the ability of a fund board to elect to impose a temporary, 10-day maximum, redemption gate in times of stress without being required to subsequently liquidate the fund provides an additional tool to make a fund more stable and resilient, rather than less so. Thus, from a policy perspective, investments in non-government money market funds should not fail to be eligible for favorable reserve treatment merely because the fund is subject to the temporary redemption gate provisions of the Amended Rule.

Because we believe the changes related to redemption fees and gates actually make non-government money market funds stronger, and that a fluctuating NAV does not make shares of such a money market fund any less bond-like than shares of a stable NAV fund, we respectfully request that the NAIC retain the Class 1 List, but with certain changes to the existing provisions under Part Six, Section 2(b)(ii) of the P&P Manual so that they are consistent with the changes that are being implemented by the Amended Rule. Specifically, we would suggest modifying subsections (B) and (C) of this Section 2(b)(ii) as follows:

- (B) *calculate its net asset value in accordance with 17 CFR § 270.2a-7;*
- (C) *allow a maximum of seven-day redemption of proceeds under normal market conditions;*

The existing name of the "Class 1 List" might also be modified to be more reflective of the types of funds that would be listed therein. For example, the name might be changed to the "Non-U.S. Direct Obligations/Full Faith and Credit Exempt List" or the "Other Money Market Funds List."

In addition to the above, we also respectfully request that the NAIC consider creating another new category of funds that would be eligible for favorable reserve treatment for reporting insurance companies. Under Section 3(c)(7) of the 1940 Act, certain private funds are excluded from the definition of an investment company and, consequently, are not required to register under the 1940 Act. As a result, private funds with short-term investments strategies that are comparable to those of money market funds ("Private Liquidity Funds") would not be subject to the Amended Rule. Accordingly, Private Liquidity Funds would be permitted to offer a stable NAV of \$1.00 per share and a maximum of seven-day redemption of proceeds as currently prescribed by existing provisions of the P&P Manual.

The Class 1 List has provided the NAIC's insurance company constituents with an important cash management tool: the ability to invest in certain money market funds at preferential reserve rates. This is a concept that Dreyfus fully supports, and we believe that the incremental changes that have been suggested would allow those companies to continue to avail themselves of these valuable investment vehicles. As a practical matter, when reporting insurance companies have the complete flexibility to choose from a broad range of money market fund types, including non-government money market funds and Private Liquidity Funds, they are in a better position to achieve favorable and prudent investment outcomes. Thus, an appropriate range of money market investment choices can help ensure that reporting insurance companies will be able to meet their future financial obligations. We appreciate the opportunity to present our perspectives and suggestions on this issue, and we look forward to hearing from you with any questions or comments you may have.

Sincerely,

Tracy A. Hopkins
Vice President, The Dreyfus Corporation



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Investors should consider the investment objectives, risks, charges and expenses of a mutual fund carefully before investing. Call your BNY Mellon Fixed Income Representative or download from dreyfus.com a prospectus, or a summary prospectus, if available, that contains this and other information about the fund, and read it carefully before investing.

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation, or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in a money market fund. Fund yields fluctuate.

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